

REPORT FOLLOW-UP

AGENCY: OFFICE OF THE STATE TREASURER

On April 5, 2005, the Legislative Services Office released a *Management Report on Financial Procedures* for the Office of the State Treasurer for fiscal years 2002, 2003, and 2004. The Office was contacted on June 22, 2005, and this follow-up report addresses how it has responded to the one finding and recommendation contained in that report.

STATUS OF RECOMMENDATIONS:

FINDING #1 – Internal controls are inadequate to ensure the accuracy of all transactions in the Local Government Investment Pool (LGIP). Following are examples of weaknesses in the internal control system that need improvement:

1. The application used to calculate earnings for LGIP participants does not have edits to restrict changes to the underlying security information. Additionally, the Office does not require evidence of supervisory review and approval of changes to the investments. As a result, manual adjustments to certain investments accelerated premium amortization and overpaid participants by approximately \$112,000.
2. Adequate documentation explaining the purpose of investment trades and how those trades correlate to the Treasurer's investment policies was not available for eight securities sold during fiscal year 2004 for losses totaling \$1,047,950.
3. Calculated participant earnings are not reconciled to the monthly LGIP transaction report to ensure that the amounts earned are actually distributed in the appropriate pro-rata share.
4. The application allows adjustments made in the current period to affect prior period reports. This changes reported amounts that may have previously been used for earning distributions or pool valuations. Current transactions should affect the reports prospectively, retaining the integrity of past transactions, distributions, and valuations.

We recommended that the Office improve internal control procedures for the LGIP by implementing an approval and review process over investment transactions, providing adequate documentation to support investment transactions, preparing reconciliations to ensure income is calculated and distributed to the participants accurately, and ensuring that the integrity of past transactions, distributions, and valuations is maintained when adjustments or correcting entries are made.

AUDIT FOLLOW-UP – The Office has implemented several control procedures that specifically address these weaknesses, such as:

1. Two administrators have been designated to oversee investment applications used to account for the LGIP. These administrators are not involved in day-to-day trading or investing activities and are the only employees authorized to change security information that has been entered from the trade packets. Further, the Office has established employee profiles within the application, thereby limiting employee access and specifying what approvals are necessary.

2. A reconciliation review process has been implemented for LGIP security trades. One employee is responsible for entering LGIP trades, after approval from the investment manager, while a second employee reconciles the trade packet information with the custodial month-end bank statement.
3. The investment manager reviews participant account distributions, and agrees the current distribution to the income to ensure that the amounts earned were appropriately distributed to participants.
4. The application now includes a 60-day hard close process. This process basically provides that 60 days after a specific month's end, data is no longer accessible for changes.

STATUS – CLOSED